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TAGS: ECIN ETRD PREL ECON BR
SUBJECT: MERCOSUL: CRITICISM GROWS BUT GOB POLICY SHIFT UNLIKELY

REF: A) 04 BRASILIA 2885, B) 04 SAO PAULO 1659, C) BRASILIA 91, D) 04 NEW DELHI 6407

¶1. (U) This cable reflects input from Consulates General Rio de Janeiro and Sao Paulo. Mission invites comment from other posts in the region regarding issues raised herein.

¶2. (SBU) Summary and Introduction. The Brazilian private sector has recently stepped up criticism of GoB trade policy, in particular the government's emphasis on expanding relations with developing (as opposed to developed) countries. Failure of the December 17 Mercosul summit to significantly advance the bloc's program toward achieving a customs union, the relative insignificance of Mercosul trade for Brazil, and frustration over Argentine restrictions on Brazilian exports have caused some in the private sector to propose that the bloc devolve into a free trade area, liberating its members to pursue independent foreign trade policies. Despite this increasing assertiveness by the private sector on trade matters, and in particular on Mercosul, unless President Lula personally changes course it is highly unlikely that the GOB will abandon or dramatically curtail Mercosul integration because of industry concerns. Despite its apparent lack of substance, support for regional integration runs deep within the President's PT party and the Foreign Ministry. Foreign Minister Amorim played a prominent role in Mercosul's formation while serving in the same position during Itamar Franco's presidency and sees it as a key building block for the larger ideal of a united South America (led, presumably, by Brazil). And while President Lula is certainly aware of the industry's complaints, so far he has consistently supported Amorim's vision. End Summary and Introduction.

Plethora of Private Sector Complaints

¶3. (SBU) Mid-way through the Lula administration, the Brazilian private sector has stepped up its criticism of GoB trade policy. The more strident complaints have been touched off by a series of government actions and "failures" that reflect a widening breach between private sector and government interests. The list of GoB misconduct includes: the suspension in FTAA negotiations; the failure to conclude free trade negotiations with the EU in October; the granting of "market economy status" to China in November (ref a and b), and the GoB's conciliatory stance toward Argentina as it imposes restrictions on a host of Brazilian exports. In reacting to these events, the business community, as well as a number of respected analysts, has accused the GoB of subordinating tangible commercial interests to outdated ideological biases based on North-South conflict and to unrelated geopolitical objectives.

¶4. (SBU) Basically, the GoB is under attack for its emphasis on relations with other developing countries and the perception that these ties are being pursued at the expense of relations with Brazil's major markets, i.e., the United States and the EU, which together receive nearly 50 percent of Brazil's exports. Given the lackluster results of the recent Mercosul Summit (ref c), criticism more recently has centered on what is perceived as the GoB's desire to preserve Mercosul at seemingly whatever cost.

Excessive Focus on Mercosul?

¶5. (U) Mercosul detractors point to the bloc's decreased importance to Brazil as a trading partner and the minimal economic pay-off likely to result from Mercosul's "successful" trade initiatives to date. Following the 1994 Protocol of Ouro Preto, Brazil's trade with its Mercosul partners grew rapidly, from $10.5 billion in 1994 to $18.5 billion in 1997, with exports and imports in relative balance. But after leveling off in 1998, Brazil's trade with Mercosul members declined following Brazil's currency

devaluation in 1999 and Argentina's subsequent financial crisis, reaching a low of $8.9 billion in 2002. In 2003, Brazilian exports to the bloc started to rebound, growing 95 percent from the low 2002 level. Although a further 59 percent growth in exports and 12 percent growth in imports from January through November 2004 have lifted two-way trade to around $15 billion, it still remains well below the peak trade level recorded in 1997. Furthermore, despite recent growth in Brazil-Mercosul trade, the bloc's relative importance as a trading partner has declined. Trade with Mercosul members accounted for 13.7 percent of Brazil's trade in 1994, dropping to 9.6 percent a decade later.

¶6. (U) Nor are the bloc's newly inked trade deals with India, the Southern Africa Customs Union, and with the Andean countries expected to produce substantial trade gains for Brazil. Brazil's trade with India currently stands at a mere $1.2 billion, and the Mercosul-India agreement covers only 902 products, about 450 for each side. With respect to the SACU (principally South Africa), total trade is about $1 billion, in comparison with Brazil's expected $160 billion in overall two-way trade for ¶2004. The partial, tariff preference agreements with these countries are only expected to marginally expand access for Brazilian products (refs c and d). [Note. In a December 28 editorial, former Brazilian Ambassador to the U.S., Rubens Barbosa, claimed the private sector had not been consulted and was unaware of which products were covered by these agreements. During December 13-14 meetings with AUSTR Broadbent, an array of Brazilian business people leveled similar complaints about inadequate consultations by the GoB on international trade negotiations in general.]

¶7. (U) Likewise, recent trade agreements with Peru, Ecuador, Colombia and Venezuela have generated little enthusiasm among the private sector as industry has complained about the complex set of rules of origin, the large number of exceptions, and the longer tariff phase-out accorded to the Andean countries. The GoB points to growth of around 50 percent in trade between Brazil and the Andean Community in 2004 as indicative of the importance of the trade relationship, but this is from a base of only $3.7 billion in 2003. Brazil-Andean Community two-way trade totaled a mere $4.5 billion through October 2004.

Negotiating by Committee

¶8. (SBU) Critics also disagree with claims by the GoB that Brazil's leverage vis-a-vis major trading partners is enhanced by negotiating as a member of Mercosul, contending that conflicting national interests within the bloc impede its ability to conclude negotiations with the United States and the EU. The Brazilian private sector insists it was Argentine protectionism that forced Mercosul negotiators to reduce the level of ambition in the last offer presented to the EU, in part causing those negotiations to stall before an October 31, 2004 deadline. Although the business community acknowledges that in the FTAA negotiations additional factors are at play, such as Brazil's reluctance to discuss IPR or new investment rules, many here believe that unburdened by its less competitive neighbors, Brazil could more easily find the basis for a mutually advantageous trade agreement with the United States.

Argentina-Brazil "Refrigerator War"

¶9. (SBU) Argentina's persistent efforts to restrict Brazil's exports in the so-called "refrigerator wars," and a perceived complacency on the part of the GoB, have also highlighted the costs of Mercosul integration for the Brazilian business community. Over the last decade, Argentina has typically enjoyed a small, but positive trade surplus with Brazil. Nonetheless, rebounding Brazilian exports in 2003 prompted Argentine complaints about import surges in various electrodomestic products. Argentina's emerging trade deficit with Brazil in 2004 provided additional fuel for that country's demands that restrictions be applied to Brazilian exports of refrigerators, washing machines, ovens, televisions, shoes, and certain textiles. From January through November 2004, Brazilian exports to Argentina expanded another 64 percent reaching $6.7 billion, compared with only 19 percent growth ($5.1 billion total) in trade in the opposite direction.

¶10. (U) The conciliatory posture the GoB has adopted, encouraging Brazilian producers to negotiate various "voluntary" export restrictions, has provoke outrage by the Brazilian private sector, and at times by Minister of Development and Trade Furlan. Brazilian refrigerator producers accepted a monthly quota of 18,160 units, down from the 26,354 being sold, limiting their market share to 50 percent. Since July, Argentina has assessed a 21.5 percent additional tariff on televisions manufactured in

Brazil's Manaus Free Trade Zone and has been pressing for voluntary limits to reduce yearly imports from 160,000 to 17,500. The Argentines are also seeking a reduction in market share for Brazilian washing machines from 49 percent to 35 percent and subjecting imports to a non-automatic licensing regime.

¶11. (SBU) The final straw for some came in the run-up to the December 17 Ouro Preto Summit, when Argentine negotiators pressed Brazil to accept adoption of a safeguard mechanism within Mercosul that would automatically impose quotas should neighboring countries' currency values and rates of economic growth vary substantially. After convening key advisors, on December 8 President Lula flatly rejected the proposal, raising concern that the trade spat could ruin the upcoming summit. Although the safeguard proposal was not on the summit agenda, the presidents of Uruguay and Paraguay publicly supported Brazil's position. However, the war is far from over. Brazilian and Argentine negotiators agreed to set aside the negotiations on export restrictions and on a potential safeguard for the sake of the summit, but discussions will resume in January.

For Brazil, Which Road Forward?

¶12. (SBU) Given the political importance of Mercosul, few in Brazil would advocate a complete abandonment of the bloc. However, two schools of thought are emerging on how best to cure Mercosul's ills. One group believes that a looser association that allows for greater flexibility in accommodating varying national economic interests is the way to go. This group has proposed that Mercosul devolve into a free trade area, allowing the free flow of goods between members, while enabling them to orient their trade with other partners according to national priorities. Roberto Gianetti da Fonseca, former Executive Director of the GoB's trade chamber (CAMEX) during the Cardoso administration, and currently head of International Relations at the powerful Sao Paulo FIESP industrial federation, has been publicly championing this cause. His proposal has rankled Itamaraty (i.e., Brazil's Foreign Ministry), but resonates among many business leaders.

¶13. (SBU) The other group, led by President Lula and Foreign Minister Amorim, argues that it is more, not less, integration that is needed and see current Mercosul problems as mere growing pains. Minister Amorim has exhorted the business community to keep the bigger picture in mind -- the long-term goal of transforming Mercosul, and eventually the South American Community of Nations, into an EU-type arrangement. Brazilian officials point out that the EU's own formation has been a lengthy and at times contentious process. While acknowledging the trade difficulties and attempting to work through them, the GoB's answer is also to press ahead with political integration as quickly as possible to lock-in the integration process. Recent steps to strengthen Mercosul institutions in Montevideo, and to install a Mercosul parliament in 2006 are regarded as key steps in that process.

¶14. (SBU) With Lula lining up with ForMin Amorim, its pretty clear which road forward the GOB will take. Despite the increasing assertiveness by the private sector on trade matters, and in particular on Mercosul, unless Lula personally changes course it is highly unlikely that the GOB will abandon or dramatically curtail Mercosul integration because of industry concerns.

CHICOLA